A Return to *Von's Grocery*?

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In 1966, the Supreme Court held in *United States v. Von's Grocery Co.*[1] that a merger between Von's Grocery Company and Shopping Bag Food Stores, which created a firm with a combined market share of just under 8 percent, violated Section 7 of the Clayton Act.[2] After a firestorm of criticism from the business community that no merger between competitors was safe from challenge,[3] the 1968 Horizontal Merger Guidelines for the first time set forth a number of bright-line statistical thresholds for merger enforcement, including a provision that the government was unlikely to challenge a merger where the combined share of the merging parties was under 8 percent.[4]

Since 1968, the many revisions to the Merger Guidelines reflect two general trends. First, the revisions in 1982, 1992, and 2010 substantially reduced the number of mergers subject to challenge on the theory of coordinated effects. The revisions achieved this by increasing the thresholds necessary for coordinated effects and by setting forth the market conditions necessary for coordinated effects to take place. These revisions reflect the empirical evidence that many markets are not susceptible to coordinated effects and those that are require higher concentration levels than previously thought.

Second, the revisions in 1992 and 2010 expanded the number of mergers subject to unilateral effects analysis. Indeed, the 2010 Merger Guidelines eliminated every statistical threshold used to determine whether unilateral effects would plausibly result from a merger. The elimination of such thresholds (however flawed)—and the failure to replace them with other, more prudent limits—is particularly troubling because it is almost impossible to test the plausibility of unilateral effects in any empirical manner. In this way, the newest iteration of the Merger Guidelines potentially returns us to the days of *Von's Grocery*, when businesses are unable to determine with any degree of certainty whether particular mergers are likely to be challenged by the Government.

Trends in Coordinated Effects

To see how much the Herfindahl-Hirschman Index (HHI) thresholds have increased over the years, it is helpful to review the HHI thresholds that the Government and businesses have used to identify mergers likely to be challenged under each iteration of the Merger Guidelines. As shown in Figure 1, the definition of "highly concentrated" has increased from as low as 1400 in the 1968 Guidelines to 2500 in the 2010 Guidelines, with the delta necessary for a presumption of anti-

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1 384 U.S. 270 (1966).

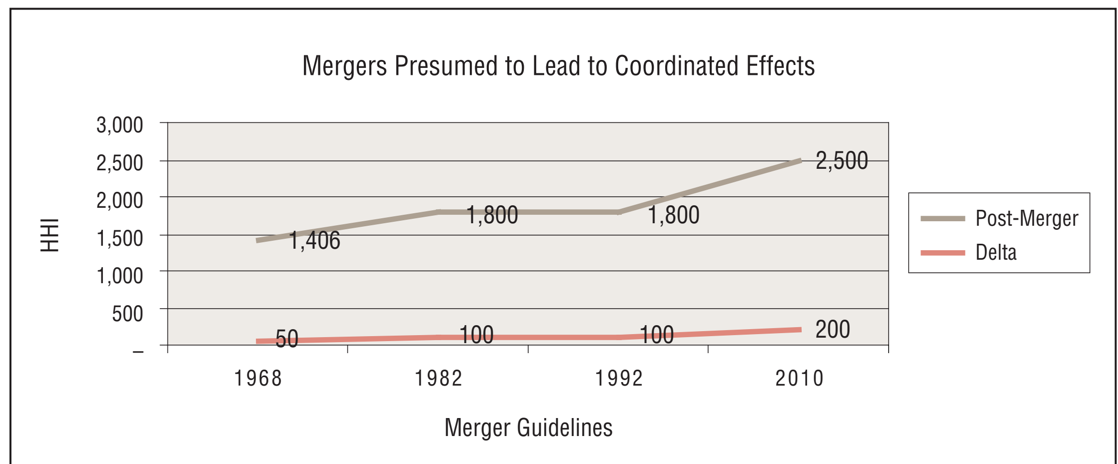
2 *Id.* at 272, 277.

3 For example, Justice Stewart complained that the sole consistency in Section 7 litigation was that "the Government always wins." *Id.* at 301 (Stewart, J., dissenting). *See also* RICHARD A. POSNER, ANTITRUST LAW 105–09 (1976).

4 U.S. Dep't of Justice, 1968 Merger Guidelines § I.5, at 6, *available at* http://www.justice.gov/atr/hmerger/11247.pdf.

competitive effects in highly concentrated markets increasing from as low as 30 points in 1968[5] to 200 points in 2010.[6]

Figure 1



This increase in the statistical thresholds reflects the view that coordinated effects are only likely to occur at very high statistical thresholds and only where certain market conditions are met. Importantly, this conclusion is subject to empirical testing. For example, in many mergers (and industries), there is significant variation in concentration across time and geographic markets. One can then test whether higher concentration levels in one market lead to higher profits or prices than in markets with lower concentration levels. If this empirical examination does not reveal differences in competition as a result of higher concentration levels in the past, it is difficult to predict reliably an increase in the future.

Unilateral Effects

The 1992 Guidelines introduced the concept of unilateral effects to merger enforcement. Because unilateral effects analysis depends upon switching, survey, or scanner data that are frequently hard for the merging parties to acquire, it is difficult to come up with easy-to-understand statistical metrics that can signal to the business community which transactions are likely to trigger an investigation or enforcement action. The 1992 Guidelines attempted to resolve this problem by introducing two statistical thresholds: first, that unilateral effects were unlikely where the post-merger HHI was lower than 1800;[7] and second, that the government would presume that a significant number of consumers regarded the products of the merging parties as their first and second choices if the parties' combined market share was over 35 percent.[8]

[5] The 1968 Guidelines stated that markets where the four largest firms in the industry had a combined market share of more than 75 percent were "highly concentrated" and that the Department would "ordinarily" challenge a transaction in highly concentrated markets where the acquiring and acquired firm had market shares of at least 4 percent. *Id.* § I.5 at 6. Assuming an equal distribution of market shares, the lowest HHI that would correspond to a CR4 of 75 percent would be approximately 1400. The lowest delta arising from a combination of firms with a share of at least 4 percent would be approximately 30 points. For transactions falling below the 75 percent (or 1400) threshold, the 1968 Guidelines stated that the transaction must result in a delta of roughly 50 points.

[6] U.S. Dep't of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines § 5.3, at 19 (Aug. 19, 2010) [hereinafter 2010 Guidelines], *available at* http://www.justice.gov/atr/public/guidelines/hmg-2010.pdf.

[7] U.S. Dep't of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines § 1.51, at 16 (1992, rev. 1997), *available at* http://www.justice.gov/atr/public/guidelines/hmg.pdf.

[8] *Id.* § 2.211, at 23–24.

The 2010 Guidelines eliminate these statistical thresholds, in large part because the concept of "market" does not necessarily make sense in the context of unilateral effects. In their place, the 2010 Guidelines cite to the usefulness of diversion ratios, upward pricing pressure (UPP), and merger simulation.[9] Lost in the haze of coefficients and confidence intervals is the somewhat troubling fact that the sine qua non of unilateral effects—the ability of firms to reposition in the event of a unilateral exercise of market power by the merged firm—is almost completely unsusceptible to empirical examination. At best, one might test what happens when one of the two merging firms is unavailable for a given bidding contest, but such a test does not necessarily replicate the profit opportunities presented by the permanent unavailability of a competing firm as a result of a merger.

Perhaps more significantly, evidence as to the likelihood of repositioning is in the hands of competitors who have every incentive in the world to downplay their ability to reposition, especially in mergers that would allow the merged firm to lower price or improve quality. An extreme example of this occured in 1999 and 2000 when the Regional Bell Operating Companies (RBOCs) filed thousands of pages with regulators in opposition to the merger of the near-bankrupt and since-acquired WorldCom and Sprint, claiming that the RBOCs would be unable to compete in the tightly controlled "oligopoly" of long distance telephony that the ROBCs now dominate.[10]

Indeed, taken to the extreme, the 2010 Guidelines could support the conclusion that unilateral effects are possible even where the post-merger HHI is under 1000 and the combined market shares are under 8 percent. For example, Malcolm Coate and Joseph Simons argue that UPP analysis "could essentially condemn" a merger between "six equally situated pre-merger entities with margins as low as 30 [percent]."[11] In other words, the 2010 Guidelines would permit a challenge to a merger with market shares similar to those found in *Von's Grocery*, provided there was evidence that a significant number of customers regarded the merging firms as their first and second choices (which was absent in *Von's Grocery*)[12] and testimony of rivals that they could not replace the competition previously provided by one of these two firms.

The Importance of Caution

There are many reasons to caution against Government involvement in the economy. It is difficult for regulators to predict the future and the process of such prediction is so time consuming and expensive that only those firms that are likely to obtain supracompetitive returns from a particular regulatory outcome are likely to participate in the process.[13] Trends in antitrust jurisprudence over the last forty years reflect judicial awareness of this problem. Specifically, in the context of Section 2 of the Sherman Act, courts have construed the antitrust laws to permit both the possession of

[9] 2010 Guidelines, *supra* note 6, § 6.1, at 21.

[10] Comments, *In re* Applications of Sprint Corp. Transferor, and MCI WorldCom, Inc., Transferee, for Consent to Transfer Control of Corporations Holding Commission Licenses and Authorizations Pursuant to Sections 214 and 310(d) of the Communications Act and Parts 1, 21, 24, 25, 63, 73, 78, 90, and 101, CC Docket No. 99-333 (FCC 2000); Opposition of SBC Commc'n, Inc., *Id.*

[11] Joseph J. Simons & Malcolm B. Coate, Upward Pressure on Price (UPP) Analysis: Issues and Implications for Merger Policy 17 (Working Paper, July 8, 2010), *available at* http://ssrn.com/abstract=1558547.

[12] *Von's Grocery* departs from the 2010 Guidelines on this ground as "Von's stores were located in the southern and western portions of the Los Angeles metropolitan area, and . . . Shopping Bag stores were located in the northern and eastern portions." 384 U.S. 270, 295 (1966) (Stewart, J., dissenting).

[13] *See, e.g.*, E.C. Pasour, Jr., *Economists and Public Policy: Chicago Political Economy Versus Conventional Views*, 74 PUBLIC CHOICE 153, 155 (1992), *available at* http://www.jstor.org/stable/30025594 (subscription required).

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market power and the extraction of monopoly rents in the form of reduced output or higher prices by firms with market power.[14] In the context of Section 1, courts have narrowed the antitrust laws to permit the inference of an agreement only where there is evidence that tends to exclude the possibility of unilateral behavior,[15] and, even then, only when the agreement has actually resulted in anticompetitive effects or is likely to result in the unilateral exercise of market power within a properly defined relevant market.[16] And in the context of coordinated effects under Section 7, both courts and agencies have reduced the number of mergers that are likely to be challenged by raising statistical thresholds and setting forth specific requirements for coordinated effects to occur.[17]

The evolution of unilateral effects, however, represents just the opposite trend. Not only have the agencies eliminated market share statistical thresholds, but they have dispensed with the requirements of market definition altogether. What is more, they have expanded on a theory of competitive effects predicated on a prediction of the ability of rivals to reposition—a determination that is not only rarely susceptible to empirical proof but also depends critically on evidence from competitors who have every incentive to oppose procompetitive mergers or force the parties to dispose of valuable assets in a divestiture firesale.

The point being made here is not that unilateral effects necessarily require market definition, high concentration levels, or a majority of customers who regard the merging parties as their first and second choices. Rather, it is that in the absence of some limits on the power of the government to find unilateral effects, the number of cases in which the government could make a mistaken prediction will be higher than in the presence of such limits. Thus, while the 2010 Guidelines provide transparency into the process that the government uses to evaluate mergers, they fail to fulfill another important function of Merger Guidelines, which is to let merging parties know *ex ante* whether a merger is likely to be challenged so they can accurately size and price the antitrust risk. In this context, it is worth noting that the 1968 Guidelines were a response, in part, to the 1955 Report of the Attorney General National Committee to Study the Antitrust Laws, which listed such a "dizzying list of factors" to evaluate the competitive effects of mergers that they provided the business community with no guidance at all.[18]

Conclusion

The 2010 Guidelines make it difficult to provide meaningful counsel to merging parties on their likelihood of avoiding antitrust scrutiny in differentiated products markets where the answer to the question "do you compete head-to-head for some customers" is yes. This is especially true where there is significant opposition to the merger, even if that opposition comes from rivals who are willing to spend considerable resources to conjure up evidence that they cannot reposition their products. On the flip side, the courts are likely to put some limits on the ability of the government to act on predictions of the future, although that does not avoid the risk that mergers will be unnecessarily delayed, or even terminated, because of regulatory uncertainty. ●

[14] "The mere possession of monopoly power, and the concomitant charging of monopoly prices, is not only not unlawful; it is an important element of the free-market system." Verizon Commc'ns, Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398, 407 (2004).

[15] Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 588 (1986).

[16] Toys "R" Us v. FTC, 221 F.3d 928, 937 (7th Cir. 2000).

[17] *See generally* FTC v. Arch Coal, Inc., 329 F. Supp. 2d 109 (D.C. Cir. 2004).

[18] Derek C. Bok, *Section 7 of the Clayton Act and the Merging of Law and Economics*, 74 HARV. L. REV. 226, 256–57, 271 (1960).